No. 4693

IN THE

United States Circuit Court of Appeals

FOR THE

Ninth Circuit

IN THE MATTER OF
RUSSELL O. DOUGLASS,
Bankrupt,

RUSSELL O. DOUGLASS,
Petitioner,

vs.

ROY W. BLAIR, as Trustee in Bankruptcy of the Estate of Russell O. Douglass,
Respondent.

Brief For Petitioner and Claimant

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BRIEF FOR PETITIONER AND CLAIMANT.

STATEMENT OF THE CASE.

Claimant, Russell O. Douglass, is now, and at the time of the filing of his petition in Bankruptcy, to-wit: May 22nd, 1924, was engaged

in the business of operating a passenger stage line between the Town of Folsom and the City of Sacramento, which business was and is his individual business and property. In addition to this, claimant was the owner of an equal one-third interest in the partnership business and firm known as Pierce, Pierce and Douglass; the said partnership being the owners of extensive timber lands in El Dorado County, together with saw-mills and other real and personal property all of the value of $37,750.00. (Tr., p. 13.)

On the 19th day of May, 1924, certain of the partnership-creditors, whose claims constituted an individual and a partnership liability, to-wit: Promissory notes signed by the partners, as partners and as indivduals, for money used in the firm business, brought suit and attached the business and property of claimant. (Tr., pp. 18-19.)

Claimant, then, in order to protect his individual business and creditors, to minimize the cost and obtain an adjudication of these matters in one proceeding, sought the aid of the Bankruptcy Court and an adjudication on his petition was made by said court on the 22nd day of May, 1924. (Tr., p. 11.)

The remaining partners refused to join in

the petition in bankruptcy, refused to file a petition in bankruptcy on behalf of the firm, and did not and would not, consent to have said firm declared bankrupt.

Subsequent to the date of said adjudication, aforesaid, several meetings of the creditors were called (Tr., p. 19) and a trustee was appointed to take charge of the estate of claimant, to-wit: Roy W. Blair, Respondent herein, who was personally present and represented by his counsel on all occasions. The only individual creditor of claimant and petitioner Douglass, was one S. N. Douglass, a brother of claimant, who held a secured claim in the sum of $3000.00 (Tr., p. 12) and claimant, by his counsel, upheld his right under Section 2405 of the Civil Code of the State of California, to require application of the partnership property to the payment of its debts.

Claiming they knew the partnership holdings, and knew them to be valuable, and capable if operated by the creditors, of satisfying every indebtedness of the firm within a period of six months, in addition to which valuable assets in the form of timber, a saw-mill, and other properties would remain to the benefit of the creditors of the partnership, while if sold at auction

great loss might be incurred; certain creditors of said partnership, representing the majority, and the majority of the claims of said firm, to-wit: F. L. McGrew, C. D. Le Masters, and Curtis Cutter, entered into an express agreement by and with claimant herein with the consent of the said Roy W. Blair, trustee, respondent herein, and counsel for said trustee A. B. Reynolds, Esq., who was present and active in all these proceedings.

WHEREBY, in consideration of the transfer by claimant of all his interests in the said partnership firm and business, to them, the said creditors; said parties agreed to take over and operate and conduct the business of the said firm, in the interest of the said creditors, and for the purposes aforesaid; and when, upon the said payments being made and obligations being terminated, upon the part of the said F. L. McGrew, trustee for said creditors (that is, after satisfying all of the firm's liabilities), the said F. L. McGrew reserves the right to dispose of the remaining firm assets according to his own good pleasure. (Tr., p. 25.) Briefly, as a consideration for the transfer to the creditors of the firm of his interests in the firm property, the said creditors agreed to pay, satisfy and

discharge the firm's liabilities, with such profit to themselves as fortune might provide. (Tr., pp. 24-25.)

Pursuant to the terms of the said agreement, and relying on the promises, covenants and agreements therein set forth, claimant executed the same, and as part of the same transaction claimant made, executed and delivered to the said creditors the deeds necessary to convey to said creditors claimant's interest and interests in and to the real property of the said firm, and said deeds were by said parties accepted, said agreement was by said parties signed, and the property of the said firm was taken over by said parties, and at the time of the filing of this appeal, was still being held, operated and conducted by them, the said parties aforesaid. (Tr., p. 31.)

That, subsequent to the time of the making of said agreement aforesaid, the said trustee in bankruptcy, Roy W. Blair, respondent herein, filed a notice of election to abandon all interest of the bankrupt in and to the partnership property, with certain reservations. (Tr., p. 27.)

That, thereafter and on or about the month of October, 1924, S. N. Douglass, the only individual creditor of petitioner, whose claim in

the sum of $3000.00 was secured by a chattel mortgage (Tr., p. 12), died, leaving said claim to petitioner, claimant herein, by gift *causa mortis;* claimant thereby coming into possession of this property more than five months subsequent to the date of his adjudication, is a legal claimant against his own estate. (Remington on Bankruptcy, Section 1395.)

That, thereafter, on the 12th day of December, 1924, claimant filed a petition praying that he be discharged. (Tr., p. 31.)

That, thereafter, on the 27th day of January, 1925, the referee in bankruptcy, Evan J. Hughes, ordered claimant to turn over all of his property to the trustee Roy W. Blair, respondent herein. (Tr., p. 32.)

That, thereafter, claimant filed a petition for a review of said order. (Tr., p. 32.)

That, thereafter, to-wit: on the 14th day of March, 1925, the court, without inquiring into the merits of claimant's position, affirmed the order of the referee. (Tr., p. 32.)

That, thereafter, claimant sought to have the court confirm the agreement made between claimant and the creditors of the partnership in the month of June, 1924, aforesaid (Tr., p. 33), but could not succeed in getting the matter

before the court. (Tr., p. 33.)

That, thereafter, on July 14th, 1925, a notice of application for authority to sell the property of claimant, including his stage line and business, was published by the referee. (Tr., p. 34.)

That, on said meeting being called for the purpose last above stated, no individual creditors of the bankrupt were in attendance, and no creditors whatsoever were in attendance, and no creditors were represented at said meeting, save and except those partnership creditors and actual participants in the agreement of June, 1924, who had received all of claimant's partnership interests upon the terms and conditions heretofore set forth, and on (Tr., pp. 21-26) and who were, and are to this day, the owners and holders thereof.

That, claimant by his counsel opposed and resisted the granting of the authority to sell the individual property of the bankrupt, for the purpose of paying off the claims of partnership creditors, which, first, had already been settled by express agreement, and, second, if the partnership creditors had any right whatever to recover against the individual estate, it must be exercised only after they had completely exhausted the partnership estate. (Tr., p. 35.)

That, despite this contention upon the part of claimant, said referee ordered the trustee (who in more than a year subsequent to the date of adjudication had failed to take possession of same), to take the property and business of claimant, and sell it to the highest bidder for cash.

That, thereupon claimant sought the aid of the court to restrain the trustee Roy W. Blair, respondent herein, from proceeding with the sale of his, claimant's, said property (Tr., p. 38), and procured from Hon. A. F. St. Sure, Judge of the District Court, an ORDER TO SHOW CAUSE. (Tr., pp. 38-39.)

That, thereafter, to-wit: on the 21st day of August, 1925, the said matter being presented to the court, and the court having heard the argument of counsel for petitioner and claimant, and for trustee and respondent, herein, the court by its order regularly made and entered in said cause, denied the restraining order, and dissolved that heretofore issued, and referred claimant and his said cause back to the referee. (Tr., pp. 39-40.)

From this order claimant, feeling aggrieved, appeals.

ARGUMENT.

The bankrupt, at the date of his adjudication upon an individual voluntary petition, had a one-third interest in a partnership firm and business of the value of $12,580.00 or thereabouts, to-wit: One-third of a total valuation of $37,750.00 (Tr., p. 13). This property, in the absence of any adjudication of the firm in bankruptcy, was not available to the trustee, and could not be administered in bankruptcy without the consent of the remaining partners.

Bankr. Act, Section 5.

In re Bertenshaw, 19 A. B. R. 577.

In re Hansley & Adams, 36 A. B. R. 1, 288 Fed. 564 (D. C. Cal.)

Tate vs. *Brinser,* 34 A. B. R. 660.

Francis vs. *McNeal,* 228 U. S. 695.

Armstrong vs. *Fisher,* 34 A. B. R. 701.

Civil Code of California, Section 2405.

The partnership creditors, at the time of said adjudication of the petitioner, had two courses open for their selection. They could have compelled the firm, if insolvent, to come into the bankruptcy court, or otherwise procured the consent of the remaining partners to permit the firm to become adjudicated in bankruptcy; or, they could, if they so desired, take over under

certain satisfactory arrangements, the entire partnership business and property, and with the consent of the partners, operate, and carry on the said business to their own profit and enrichment. And having decided upon that course which seemed best to them, and having executed the necessary contracts, and taken over the property and holdings of the firm, upon a promise to pay and discharge its liabilities, they have acted well within their rights.

However, the other side of their contract presents a burden which appears to have escaped their notice, to-wit: the bankruptcy law of the United States, and the wise decisions of our Federal Courts, which hold as follows:

> "If they elect to assume such a contract, they are required to take it *cum onere,* as the bankrupt enjoyed it, subject to all its provisions and conditions, in the same plight and condition in which the bankrupt held it."
>
> *Mercantile Trust Co.* vs. *Farmers Loan Co.,* 81 Fed. 254.
>
> *Central Trust Co.* vs. *Continental Trust Co.,* 86 Fed. 517.
>
> *In re Chambers, Calder & Co.,* 98 Fed. 865.
>
> *Watson* vs. *Merrill,* 14 A. B. R. 453.

And the law of the sovereign State of Cali-

fornia, our Supreme Court having held in the case of such contracts, as follows:

> "Transfer of partnership interest, to a person not a partner, who, as part consideration, assumes debts, takes them *cum onere,* and if the credits turn out to be in excess of their supposed value, the purchaser is entitled to the excess, and if the debts are larger than is supposed, he must bear the burden."
>
> *Olmstead* vs. *Dauphiny,* 104 Cal. 635-639.

Claimant contends, and we respectfully submit, that the Supreme Court of the State of California appears to agree with the contention that, at the time of the signing of the contract between claimant, petitioner in bankruptcy, and his creditors of the partnership firm, a new firm was created by novation, to-wit: the remaining members of the partnership together with the contracting creditors, who agreed in consideration of the delivery to them of the interests of claimant in the old firm of Pierce, Pierce and Douglass, that they would operate and carry on the business of the firm, dispose of its property, and liquidate its debts.

Robinson vs. *Rispin,* 33 Cal. App. 536.

> "Sale of partner's entire interest in partnership property dissolves co-partnership."
>
> *Miller* vs. *Brigham,* 50 Cal. 615.

The solvent partners, the creditors of the partnership, and the partner in bankruptcy had a legal right to make such a contract for the liquidation and payment of the firm debts, for:

> "Where partnership property is being administered in the individual bankruptcy proceedings of one of the partners a contract such as this, will not be affected by the individual bankruptcy of the partner, for the individual estate, which is the only bankrupt estate involved, has not been depleted."
>
> *McNair* vs. *McIntyre*, 7 A. B. R. 638.
>
> Remington on Bankruptcy, Section 1651.

The purpose of the contract, was the liquidation of the partnership liabilities; and:

> "The net proceeds of the partnership property must be appropriated to the payment of the partnership debts."
>
> *In re Knowlton*, 202 Fed. 480.
>
> *In re Abrams*, 193 Fed. 271.
>
> *In re Denning*, 114 Fed. 219.
>
> *Lacey* vs. *Cowan*, 162 Ala. 546.

> "The surplus, if any, being added to the assets of the individual partners in proportion to their respective interests in the partnership."
>
> *In re Denning*, 114 Fed. 219.
>
> *Lacey* vs. *Cowan*, 162 Ala. 546.

The courts will not make contracts for the creditors of the firm, nor will they interfere with contracts legally entered into between the parties, but the courts will examine such contracts and pass upon the legality thereof, and determine the rights of the parties thereunder, regardless of the wisdom or folly displayed by either party to such contract; the contracting creditors were the creditors of the firm, and as such, could not prove their claims against the individual estate of the bankrupt partner—

Lamville County Nat. Bank vs. *Stevens,*
107 Fed. 245, 7 Corpus Juris 282

—and it may be, that this fact received some consideration prior to the execution of the agreement between themselves, the remaining partners, and the bankrupt partner.

On the death of S. N. Douglass, individual creditor of the bankrupt, the petitioner, by gift to him of the chattel mortgage left by said deceased, as security for the payment of the sum of $3000.00 about five months subsequent to the date of his adjudication in bankruptcy, became, in his new estate, the largest, and only individual creditor of his bankrupt estate, whose claim could not be fully paid.

"Property acquired after adjudication does not pass to the trustee at all, but be-

longs to the debtors' new estate, and is subject only to the claims of new creditors."

In re Smith, 1 A. B. R. 37.

In re LeClaire, 10 A. B. R. 733.

In re Wetmore, 6 A. B. R. 210, Circuit Court of Appeals of Penn. Affirming, 3 A. B. R. 700.

The trustee is the representative of the individual creditors of the bankrupt, and must preserve the estate for the satisfaction of their claims against the claims of partnership creditors. (Section 2405, Civil Code.)

The trustee, in seeking authority to sell the property of the bankrupt, sought such authority at the request of the partnership creditors, with whom a composition had already been made, and said creditors, in active operation of the partnership property under the said agreement, had disposed of several portions of the firm assets, and had paid off certain of the firm creditors. (Tr., p. 31.) This, claimant contends is contrary to the duties of such trustee and the rights of the trustee in bankruptcy under the ruling of the court in *Batchelder, etc., Co.* vs. *Whitmore,* to-wit:

"A trustee in bankruptcy cannot assert rights as representative of creditors who were parties to a prior composition with the

bankrupt which they have not sought to avoid."

Batchelder, etc., Co. vs. *Whitmore,* 122 Fed. 355.

In the instance cited above, the composition creditors and the bankrupt were both within the jurisdiction of the court, whereas in the case at bar, the partnership estate was not being administered in bankruptcy, and the firm and its creditors, had a legal right to enter into any agreement looking to a satisfactory settlement of its debts.

The right of the bankrupt to take part in such an agreement is set forth in Collier on Bankruptcy, 8th Ed., p. 238, as follows:

> "It can safely be asserted, then, that even under the present law, the assets of the bankrupt, even after the same are vested in the trustee, can be used by him, if not by direct deposit, at least by indirection, to accomplish a composition."
>
> Collier on Bankruptcy, 8th Ed., p. 238.

We think, in view of the facts and circumstances hereinbefore set forth, and the authorities cited, that the legality of the agreement of the parties Tr., pp. 21 to 26, incl.) is clearly shown, and that the parties are bound by its terms. Yet, should this Honorable Court, in its

wisdom and experience, disagree with claimant's contention, we respectfully submit that, under the laws of the State of California, Civil Code, Section 2405, and the bankruptcy laws of the United States, claimant is entitled to have all of the partnership property and assets first exhausted, before the individual rights of the individual creditors of the bankrupt are impaired and lost by reason of a sale of his individual estate at the request of the firm creditors.

In re Denning, 114 Fed. 219.
Lacey vs. *Cowan,* 162 Ala. 564.
In re Abrams, 193 Fed. 219.
In re Knowlton, 202 Fed. 480.

We also respectfully submit that, having taken possession of the firm properties, and having operated and conducted the same for a period of eighteen months, the contracting creditors should be compelled to account for the proceeds received from the sale of the firm property, both real and personal, and if any further indebtedness has been incurred by them, in their effort to operate the same, that they, and not the former partnership firm, should be ordered to make good such indebtedness.

And that, until such time as these matters have been settled and shown to have been ac-

complished to the satisfaction of the court, said trustee, Roy W. Blair, respondent herein, and said creditors should be enjoined and restrained from interfering with the individual estate of the bankrupt.

That, should the court agree with the contention of this claimant, to-wit: that the partnership creditors are bound by their contract to the assuming of the partnership liabilities, and must abide by their agreement; then, claimant prays that the court make an order dismissing the petition in bankruptcy of petitioner Russell O. Douglass, upon his paying such regular costs and charges as may have been legally incurred in the administering of his estate, he being the only individual creditor remaining unpaid, by reason of the creation of the new estate in him, as set forth on pages 13 and 14 of claimant's brief herein.

Dated at Sacramento,....., 1926.

Respectfully submitted,

PETER J. WILKIE, Esq.,
Attorney for Petitioner and Claimant.

Due service and receipt of 3 copies of the within is hereby admitted this 20th day of January, 1926.

A. B. Reynolds

Attorney for Respondent.